

\$50.00 ANNUALLY
40 Letters Per Year

DOW THEORY LETTERS

"The Market as Interpreted under the Dow Theory"

RICHARD RUSSELL
P. O. Box 15196
San Diego 15, California

Registered with the Securities and Exchange Commission

March 12, 1962

Number 173

Page 1

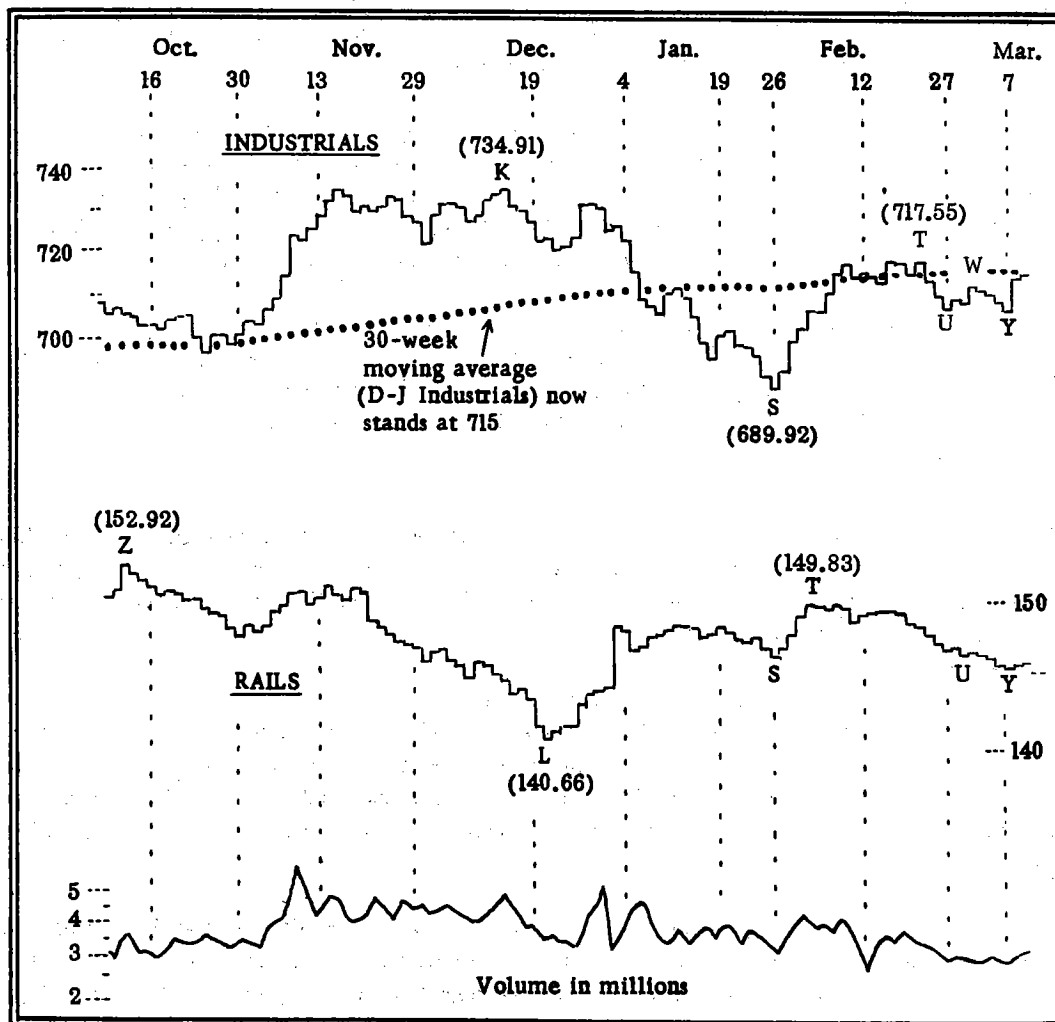
THE MARKET Following the all-time high of 734.34 established in December, 1961, the Industrial Average provided market students with a study in what Hamilton called "... the market pendulum swinging towards perfect equilibrium". The December-January (K to S) decline erased 45 points from the 168 point rise which began in October, 1960. The January rally (S to T) corrected 28 points of the preceding K-S decline. In ever-decreasing arcs, the minor T-U decline succeeded in retracing 11 points of the S-T rally, and the little U-W rise corrected 5 points of the T-U decline. Volume throughout this series of pendulum swings grew progressively dull, and by the end of February transactions decreased to an average of less than 3 million shares per day.

At W, the market seemed to have arrived at Hamilton's state of "perfect equilibrium". Even the Rails, the leaders on the decline (see Letter 172), seemed to lack impetus. Having broken under their preceding low at S, the Rails sank lazily lower but held within a two point range for 8 consecutive days prior to Y.

On March 8 the market seemed finally to shake out of its lethargy. Industrials jumped over 7 points as volume rose to 3.2 million shares (relatively low volume but still the highest in eight trading days). Rails, on March 8, budged up a token 18¢. The March 8 rise took Industrials above their preceding minor high at W, thereby forming a little ascending zig-zag. This leaves only one point of resistance between the current Industrial level and the all-time high of 734.34 -- that point is the February peak of 717.55 (T). If the Industrial Average succeeds in hurdling the T level, my feeling is that the odds favor a new Industrial high (above 734.34).

A few observations are worth making at this time: (1) The advance-decline ratio is far below its May, 1961 peak, and a considerable distance from its November peak (see Letter 170). As of this writing, the Industrial Average is only 20 points from its all-time high. A new record high on the Industrial Average would open the way to a major non-confirmation between breadth and price. History shows that such non-confirmations can lead to severe reversals.

(2) Rails, having declined 15 out of 21 days following



Page 2 T, are in a position to rally. However, the carriers, too, are a goodly distance from their February high at T, and even further from their 1961 peak at Z (152.92). In other words, Rails are not within easy distance of confirming a new high on Industrials.

(3) If the advance from Y is to be the beginning of an Industrial surge through the highs, it is coming from a level this writer does not consider advantageous. Letter 172 discussed the advantages of a rally's starting from an "over-sold" condition in the market. It is my opinion that the market was not over-sold at Y.

(4) In view of paragraph 3, if the current rise from Y results in new highs for the Industrial Average, it is probable that the advance-decline ratio will turn increasingly sluggish as the move progresses. This means that the advance will become viciously selective, and to a large extent, confined to the stocks in the D-J Industrial Average. I believe it will be a dangerous move, and I suggest that subscribers who insist on "playing" it confine their trading to the stronger stocks in the Industrial Average. These include: International Harvester, Chrysler, American Telephone, Swift, Owens-Illinois Glass, International Paper and Goodyear. (U.S. Steel is a special case and was discussed in the last Letter). In addition, Wilson, Burroughs and North American as well as Celanese, Westinghouse Air Brake, National Distillers, Chadbourne Gotham, Burlington, Baldwin Lima (all recently discussed) continue to look better than the market.

CONCLUSION: The primary trend is bullish. The secondary trend remains obscure and cannot be considered definitely bullish until both Averages better the T points (Industrials - 717.55, Rails 149.83). I suggest that subscribers review the section on the "broadening formation" which appeared in the last Letter.

A GAUGE OF THE SWINGS A subscriber asks whether there is any method of gauging the relative strength of market swings -- if so, how would I rate the major rises since 1949? There is a method by which one can make valid comparisons of various market swings. Moreover, those few people who are aware of this method also understand why it has been so difficult to make money over the last twelve months.

The advance-decline ratio (A-D ratio) is representative of the advancing or declining tendencies of all stocks listed on the "Board". As a rule, the longer the majority of stocks on the Exchange can continue in a rising trend, the stronger the market advance. When the A-D ratio registers a major peak during a market advance, then (regardless of possible further strength in the Averages) the main momentum of the advance is usually over.

There have been four sizable advances since 1949, each having separate and distinct characteristics of its own. The yardstick of the performance of the A-D ratio can be applied to each of these swings, however, and the results are quite interesting. The rise in the A-D ratio from 1949 to 1953 lasted 45 months. This was one of the longest rises on record. The advance of the A-D ratio from late 1953 to early 1956 lasted 31 months. The 1957-59 rise lasted 15 months. The rise which began in October, 1960, took the A-D ratio to a peak in May, 1961, and this was a rise of 7 months.

Ten months have now elapsed since the May, 1961 peak on the A-D ratio, and for that reason I feel we can refer to the 1961 peak as a major top on the ratio. In the past when such tops have been recorded, the main momentum of the general market was usually halted. And although the Industrial Average frequently rose to new recovery highs (i.e., September, 1959 and January, 1960), the A-D ratio seldom managed to climb to a new high until a major reaction succeeded in producing a thoroughly "over-sold" market.

WHERE ARE WE? When this Service was started, I used to spend half my time arguing that the important swings of the Averages predicted forthcoming periods of expansion or contraction in the economy. Now, perhaps half of my subscribers do believe in the forecasting properties of the Averages, while perhaps 25% of them actually allow the Averages to influence decisions regarding their personal affairs.

Those of us who believe in "a tide in human affairs" are apt to keep a chart similar to the one pictured on page 3. Here we see the two Dow Jones Averages superimposed upon one of the oldest gauges of economic activity, Barron's Business Index. Barron's Index does not exactly mirror the Federal Reserve Board's Index of Production, but it is comparable to any adjusted Index such as the American Institute of Economic Research's Index, which is also pictured on this page (both Barron's and the American Institute's Index are adjusted for seasonal and long-term trends, with the latter actually based on Federal Reserve figures).

The most recent market advance, which began in October, 1960, preceded the rise in Barron's Business Index by a full two months (some other business indices including the Federal Reserve Board Index turned up as late as February, 1961). From the low of 566.05 in October, 1960, the Industrial Average climbed 168 points to an all-time high of 734.34 in December

1961. As seen on the chart, however, the Rails failed to match the Industrial performance. Rails established their post-1960 high in October, 1961, at 152.92. But it is worth noting that the 1961 Rail peak was 21 points below the peak recorded in 1959.

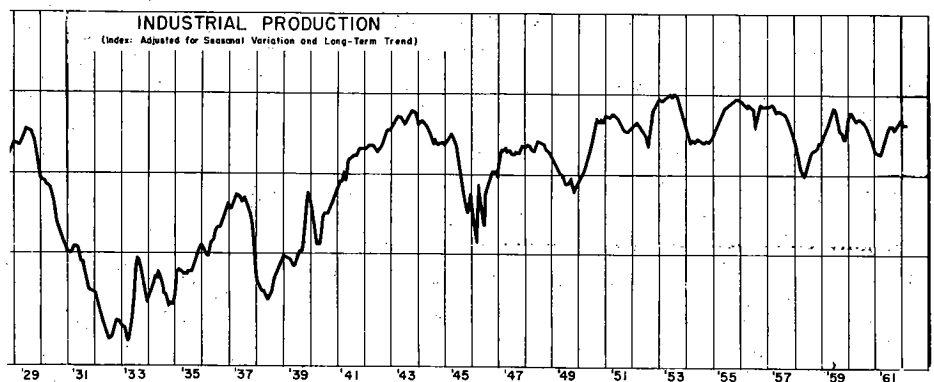
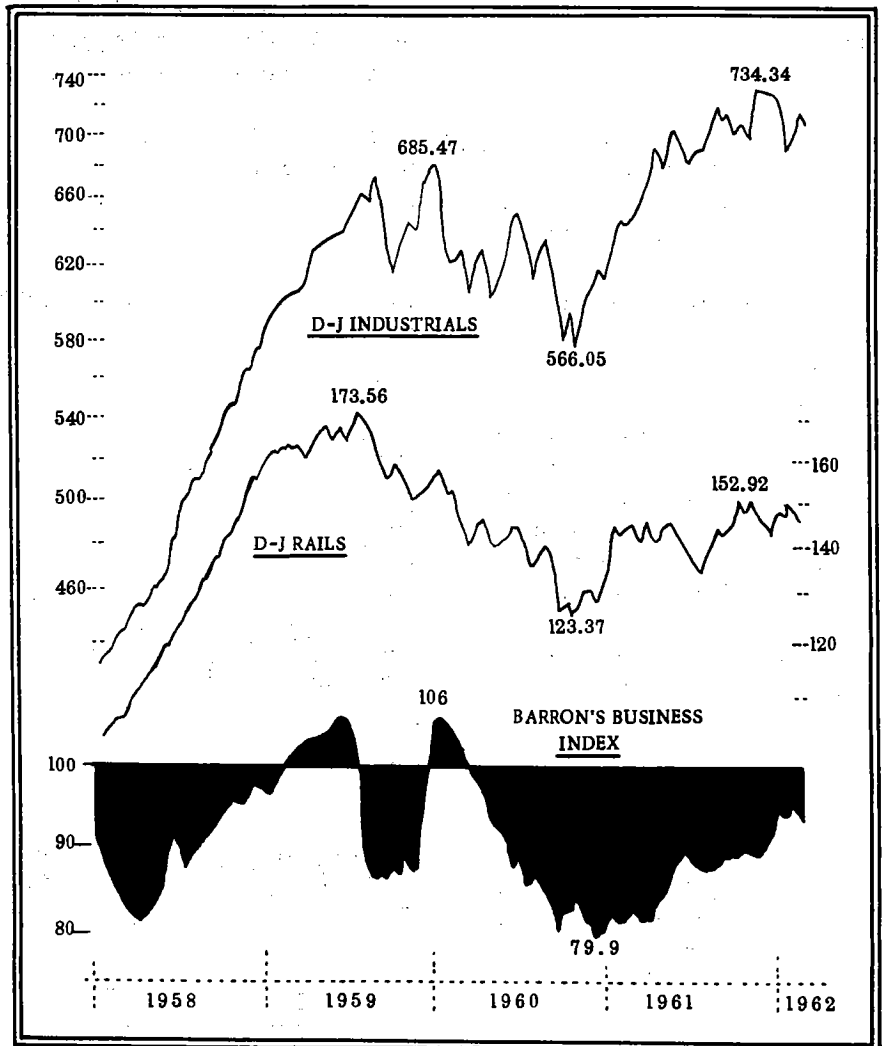
The sub-standard performance of the Rail Average and the short-lived rise of the A-D ratio (see preceding section) were undoubtedly more than coincidental. Taken together, both performances reflected early doubts concerning the strength of the stock market and the economy.

Barron's Business Index turned up in December, 1960, from a low of 79.9 registered in that month. In the space of thirteen months the Index rose to a high (January, 1961) of 94.9. As measured by Barron's Index, the latest economic recovery (like the latest stock market recovery) has been the weakest, so far, of any since 1949.

COMMENT Reliable bank credit analyses (Bolton Trembely, Harding Index) are emphatic in calling for higher prices over the longer term. But the technical position of the market suggest to me that we are not in a position for a major advance at this time. I believe (1) that the Industrial Average could rise to the 750-800 area (without much "breadth"), then go into a reaction, prior to a final advance, or (2) we could get a correction now, say back to the 660-675 area, then a major and profitable advance. In other words, regardless of bullish bank credit statistics, I would be sceptical of following an advance from here, but I would be very prone to take a position on a further reaction from this area.

STOCKS Of the 56 "key" stocks which are watched with particular care at this office, 26 are now above their ten-week moving average, a rise of 6 from last week.

I have received a number of letters asking for more particulars on my methods of stock selection. Each week charts of 350 leading stocks arrive here. These include both daily and weekly charts of each stock. In addition, about 70 stocks are charted

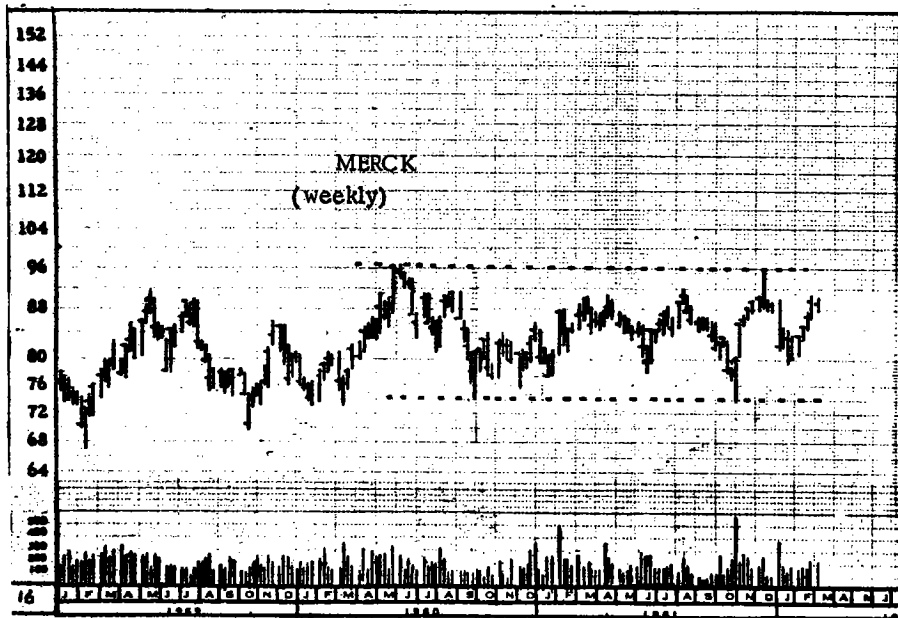


Page 4 weekly in this office, and inferences are drawn on the basis of their technical position and relationship to their own moving average. Further, continuous studies are kept of all major stock groups, their relative strength against the broad market, and their volatility. As explained in the last Letter, I prefer to work (1) on the basis of whether the market as a whole is favorable for taking or holding positions. (2) on the basis of which groups are most favorably situated, and (3) which stocks in those groups present the best possibilities for both safety and profits.

At this time I feel that the general market is not in a particularly favorable position for registering substantial gains. Within the groups, there have been a number of significant developments. Strongest groups now include textiles, paper, oils, glass and containers and drugs. Groups that are turning weaker are electronics, aircraft, autos, office equipment, food chains, electrical equipment.

One of the formations which has not appeared too frequently over the last few years is the "rectangle". The rationale for this formation is much the same as the rationale of the Dow "line" in the Averages. The rectangle and the line represent an area in which opposing forces are very much in equilibrium, and the price movements are consequently restricted to a narrow area.

For over two years Merck has fluctuated within the 74-96 area. The stock looks strong to me, and I believe it will be a leader on the upside. The minimum measurement of a rectangle breakout is usually a distance above the rectangle equal to the height of the rectangle. Since the rectangle is approximately 22 points, a rise through the high would be expected to take the stock to at least 118.



The textile group continues to be one of the strongest on the "Board". Chadbourn Gotham was recommended repeatedly in the 5 3/4-6 area, and the stock has been behaving extremely well. Last week CGI rose to 8 1/2, a new high. CGI has now formed a nice ascending trendline, and each leg of the rise has been corrected. Note the appearance of periodic heavy volume during each important additional rally. It is not unusual for a low-priced stock which is acting this well to finally gather momentum on the upside. When this happens, the stock frequently gain more in a week than it has gained in the preceding six months. Such a violent rise is often marked by a good deal of profit taking on the part of the early buyers. If CGI suddenly rises sharply, I would suggest that holders in the 6 and below area start taking some profits.

Charts courtesy of Traders Research, P. O. Box 2644, St. Louis 16, Mo.

Written Monday, March 12 at 10 A.M.

